Brandeis

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CONSOLIDATION OF GAS COMPANIES

AND OF

ELECTRIC LIGHT COMPANIES

ARGUMENT OF
LOUIS D. BRANDEIS

ON BEHALF OF

THE MASSACHUSETTS STATE BOARD OF TRADE

BEFORE THE

LEGISLATIVE COMMITTEE ON PUBLIC LIGHTING

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CONSOLIDATION OF GAS COMPANIES AND OF ELECTRIC LIGHT COMPANIES.

Argument of Louis D. Brandeis.

March 9, 1905.

Mr. Chairman,—The Massachusetts State Board of Trade has petitioned the Legislature for the enactment of a general law providing for the consolidation of gas companies and of electric lighting companies with a prohibition against stock-watering.

The Massachusetts State Board of Trade has not been represented at any of the hearings before the Board of Gas and Electric Light Commissioners, or before this Committee relating specifically to the Boston Gas Companies. It is not here to attack or to defend the action of any of these companies or of those who have been, or who now are, in control of the companies. With the specific questions arising in connection with those companies the Board of Trade has no concern excepting only this: that any consolidation which may take place shall be in accordance with the wise and established policy of the Commonwealth prohibiting stock-watering of quasi-public corporations; and that, to accomplish this end, a general law shall be enacted under which any gas or electric light companies may be consolidated.

The policy of prohibiting stock-watering is wise, and is the established policy of Massachusetts.

Anti-Stock Watering Policy Wise.

It is wise because it rests upon justice, the only stable foundation among a free people. It is just because it gives full recognition to the rights both of capital and of the public. It recognizes that those who invest their money in public service

corporations are entitled not only to a fair return on the capital, but also to profits in excess of that fair return commensurate with the risk assumed. It recognizes, on the other hand, that those who engage in a business which involves the use of public property, like the streets, undertake as trustees to perform a public service, and that they must be held accountable for their action as trustees. In entering upon such business or in investing money in such business, every person assumes, so far as he is concerned, the obligation to perform through the company the duty of furnishing to the public adequate facilities for a reasonable compensation.

The law against stock-watering rests upon the fact that, in order to determine what a reasonable compensation is and to limit the return on capital to a reasonable compensation, it is essential that there should be before the public a knowledge of the capital originally invested in the enterprise. The devious devices of stock-watering have the inevitable effect of concealing that fact from the public, and by virtue of that concealment tempt the owners of the property to make unreasonable exactions from the public.

Anti-Stock Watering Policy Well Established.

The policy of prohibiting stock-watering is also well established.

In 1894 it became the general law of the Commonwealth; but long before that date its importance was fully recognized, and recognized fully also in the administration of the gas and electric lighting business.

The only general law which exists in Massachusetts relating to the consolidation of gas or of electric lighting companies is the Act of 1887, which authorized gas companies in any city or town to engage also in the business of electric lighting, if, in the opinion of the Board of Gas and Electric Light Commissioners, such action was for the best interests of the public. In applying the provisions of the act, the Board has always inquired whether the consolidation would result in an increase

or a decrease of capitalization or of dividend charges; and its action in granting or withholding its approval has been in large measure determined by that fact.

The Board of Gas and Electric Light Commissioners showed almost from the organization of the Commission the extent to which it and the community deemed the limitation of capital an essential element in protecting the rights of the consumers.

(*a.*) *The Amherst Consolidation.*

In 1890, in the case of the Amherst Gas Company, where there was a capital of $10,000, but the value of the property of the company was $15,000, the $5,000 surplus having been accumulated in the course of busines, the Commission required the recall of an issue of $5,000 of stock to represent that surplus, because, as it said,—

"It appeared ample dividends had been paid stockholders, and therefore the consumers are entitled to share in this surplus."

(*b.*) *The North Adams Consolidation.*

In a case arising in 1891, where the North Adams Gas Company applied for permission to purchase and carry on the electric lighting business then conducted by the Adams Electric Light & Power Company, permission was granted because it involved a wiping out of the capital of the Electric Light & Power Company and the application of the surplus of the Gas Company of $19,000 to the purchase of the electric light plants, the Commissioners saying, among other things:—

"The reduction of capital by the consolidation was given and considered as a substantial reason why the Gas Company could produce electric light more cheaply than could a separate electric company."

(*c.*) *The Easthampton Consolidation.*

In 1892, when the Easthampton Gas Company granted the right to buy out the electric lighting business of the People's Com-

pany in that town, the Commission stated it was "well aware that an undue enlargement of capital in such cases is likely to obstruct the benefits which otherwise might result from a union of companies." The Board intimated that its action would depend in some degree upon the amount of capital proposed; and, when the directors of the Gas Company decided that they would not increase their capital at all, the Board consented to the consolidation.

In each of these early cases the consolidation was deemed consistent with public interest, since it did not involve any increased capitalization or dividend-burdens upon the community.

(*d.*) *The proposed Worcester Consolidation.*

The denial in 1890 of the petition of the Worcester Gas Light Company to consolidate with the Electric Light Company presents a striking application by the Board of the same principle. The Gas Company had a capital of $500,000, upon which it was paying dividends at the rate of 8 per cent. The Electric Light Company had a capital upon which it was paying dividends at the rate of 5 per cent. It was proposed to issue only $200,000 additional stock of the Gas Company to take the place of a like amount of the Electric Light Company stock. But the Commissioners foresaw that the Gas Company would not reduce the dividend from 8 per cent. to 7 per cent. or 6 per cent., but would pay 8 per cent. on the new stock as well as upon their old stock; and so the Commissioners, after a full investigation of the facts, thought that the public interest would not be advanced by that consolidation, among other reasons because an increase of the dividend charges upon capital would necessarily result in an increase of the charges upon the public, saying :—

"Probably the stockholders in the Gas Company do not expect to receive reduced dividends in consequence of the consolidation. But, with no facilities for reducing the cost of electric light, how can this rate be maintained on the enlarged capi-

tal? Apparently, either by advancing the prices or lessening the service or by using the surplus profits of the Gas Company. Either course is obviously against the public interest. The former would be adopted only with reluctance, the latter ought not to be allowed."

(*e.*) *The Boston-Edison Consolidation.*

Ten years later, when the Board of Gas and Electric Light Commissioners had occasion to comment upon the consolidation of the Edison and Boston companies under the Act of 1901, they stated:—

"These facts mark this transaction as a noteworthy instance of the consolidation of two prosperous companies of this character without an attempt to issue new stock as a mere incident of the combination."

It was proposed that the Edison Electric Illuminating Company should buy the Boston Electric Light Company. When the Legislature came to authorize the consolidation, it provided that the Edison Company should issue only so much of its stock as was absolutely necessary to acquire upon a valuation the Boston Company's stock; and, as the Boston Company's stock was of less value than the Edison stock, the result of the consolidation was an actual reduction of the capitalization.

General Legislation Desirable.

The Massachusetts State Board of Trade comes here to urge the passage of a general act governing consolidation of gas and electric light companies, in continued performance of the duty which it early assumed to prevent stock-watering of public service corporations.

To the efforts of the Massachusetts State Board of Trade is due in large measure the passage of the anti-stock-watering acts of 1894, which embody in the effective form of a general law the policy which had grown to be recognized as a wise one for the Commonwealth.

The Massachusetts State Board of Trade believes that to the law so established there should be no exceptions, and that the interests of capital as well as of the public will be best subserved by an adherence to that law without the grant of favors or special privileges to any.

In connection with the controversies arising out of the Boston Gas Companies it has been asserted from time to time that the attempt to enforce against these companies the anti-stock watering policy of the Commonwealth was communistic or socialistic.

To my mind nothing can be farther from the fact. When Massachusetts passed the anti-stock-watering laws, it adopted a measure of a most conservative character,—a measure more potent for the protection of individual private property than any other which could have been devised. The greatest factors making for communism, socialism, or anarchy among a free people, are the excesses of capital; because, as Lincoln said of slavery, "Every drop of blood drawn with the lash shall be requited by another drawn with the sword." It is certain that among a free people every excess of capital must in time be repaid by the excessive demands of those who have not the capital. Every act of injustice on the part of the rich will be met by another act or many acts of injustice on the part of the people.

If the capitalists are wise, they will aid us in the effort to prevent injustice. They should welcome anti-stock-watering legislation as tending to protect them from the temptation to do injustice.

Dangers of Special Legislation.

Hitherto we have had little occasion to deal with this matter of consolidating gas companies and electric lighting companies, except in the class of cases acted upon by the Board of Gas and Electric Light Commissioners, to which I have referred. The only class of cases provided for by the existing general law is where gas companies seek to engage in the electric lighting busi-

ness and the law empowers the Board to grant such permission after public hearing, if it is of opinion that the public interest would be advanced thereby.

The necessity for extending the scope of consolidation has, however, come. It is believed that better results can often be attained by consolidating under one management several gas companies or several electric light companies.

Shall we undertake to meet this demand by the passage of special acts, and subject the community to all the dangers and injustice attendant upon special legislation? Or shall we look over the field of the law as it exists in Massachusetts and see whether we have not now in Massachusetts some law governing the consolidation of public service corporations which has been tested by experience, and which could be extended to the case of the gas and electric light companies? This latter surely is what we should do; and, if we but look, we shall find the law providing for the consolidation of street railway companies which may serve substantially as a model for the consolidation of gas and electric light companies.

The Street Railway Consolidation Act a Precedent.

In 1898, after a most careful investigation of the subject by an able commission appointed to deal with the whole subject, the Legislature passed a law which provided for the consolidation of street railway companies whose lines connected with one another, subject always to the further provision that in the course of such consolidation there should be no increase in the amount of stock issued, that there should be no reduction in the facilities afforded the public, and that there should be no increase in the rates charged to the public, and that the consolidation should appear to the Railroad Commissioners, after public hearing, to be in the interest of the community.

That law almost in its exact wording would be applicable to the present gas situation. That statute could be applied to gas companies and to electric light companies. It has worked

well for nearly seven years in the case of the railway companies. We have every reason to believe it would work equally well in the case of the gas and electric light companies.

Boston Companies should not be Excepted.

The Boston gas companies ask to be excepted from the general policy of the Commonwealth prohibiting stock-watering in the consolidation of public service corporations. Where will such a course lead you?

If an exception is made in their favor, what will result? You will have a cry in the community of "special privileges," of the granting to some people what you deny to others. And how can that be excused?

There is only one safe course for the community, only one safe course for you and for us who want property rights protected and preserved; and that course is neither to seek nor to grant special privileges. Let us all stand equal before the law, and let the law be so just, so reasonable, so carefully drawn, that it protects alike the rights of all.

Therefore, when it comes to this matter of consolidation, whether it be of the Worcester companies or the Boston companies or the Haverhill companies or any other companies, the question ought to be always one and the same, "What is the basis on which companies should consolidate in Massachusetts?" When you have determined what the proper basis is, apply it as you apply every law under which we live,—alike to the rich and the poor, alike to one town and another town, alike to every part of the Commonwealth.

In order that that law should be fair in its operation alike to all concerned, it must necessarily be applied to the consolidation of the Boston companies. The moment that you make an exception, and grant special privileges to one set of men, you create a score of evils. You create a feeling of unrest. You lay the basis for a charge of favoritism and of injustice. This must lead to the charge that improper means have been

used to accomplish improper ends. It is almost as important to legislation as it is to the administration of justice in the courts that it should not only be pure in itself and just in itself, but that the public should recognize that it is so.

The Act of 1903.

It may be said the Act of 1903, providing for the consolidation of the Boston companies, was passed after mature consideration. I dare say much attention was given to some of its provisions; but that is no reason for permitting it to stand, if the act is inconsistent with the public interest. Consolidation has not yet been effected under that act. Fortunately, we can still avoid committing a serious mistake; for there is no such thing as any vested right in that law any more than in any general act on the statute books, and you are engaged constantly in modifying and repealing general acts.

The gentlemen who have acquired the control of these Boston Gas Companies had the control of them before they applied to the Legislature for the Act of 1903. It was because they had control of these companies that they applied to the Legislature. Their situation has been in no way changed in reliance upon the passage of the act. If they are not allowed to consolidate on the basis of twice the amount of capital originally invested, they will lose nothing more than the improper hope which was entertained at one time. They will lose nothing more than any of us lose from day to day when we build our hopes in respect to our business or otherwise upon general legislation which we think would prove favorable to our selfish interests, and which the Legislature subsequently modifies in the interest of the whole community. No right has been acquired by the Boston Gas Companies in reliance upon the Act of 1903. The situation of these Boston companies has not been changed since the passage of the Act of 1903. Proceedings have been instituted looking toward a consolidation, and a small expense has been incurred in em-

ploying lawyers and experts to accomplish that purpose; but that is all. But, even if some action had been taken that would not prevent your legislating properly now; for every act of incorporation in this Commonwealth passed for over seventy years has been granted subject to the right of the Legislature to alter and repeal. You ought not to hesitate to compel the Boston companies, if they consolidate at all, to consolidate under a general law. The interests of the Commonwealth demand it; and, in my opinion, the interests of the Gas Companies in the long run demand that they should not be permitted to do an act which the community will believe is an act of injustice, made possible through a grant of special privileges.

The Massachusetts Policy not Unfriendly to Capital.

Representatives of the financiers say, from time to time, that the attitude of the Massachusetts Legislature in restricting the capitalization and privileges of public service corporations prevents investment in this Commonwealth. I believe that statement to be absolutely unfounded in fact,—indeed, that the opposite is true; and here is the proof:—

Massachusetts stands among the States practically alone in the enviable position of having absolute control of its public service corporations, because every inch of pipe, every foot of wire, and every yard of track in the public streets in this Commonwealth can be removed at any time when the public finds it to be for its interest that they be removed. They can be removed without the payment of a single dollar in compensation to the companies owning them. For under our law the community gives to a public service company not a grant of a franchise, but merely a revocable license to lay tracks, or lay pipes, or stretch wires,—a license to continue so long as in the opinion of the properly constituted authorities of the community it is for the public interest. With no other foundation than this revocable license, and the

certainty of taxes exceeding 1½ per cent. upon the market value of the stock, hundreds of millions of dollars have been freely invested in Massachusetts public service corporations; but, what is most significant, these securities stand in the stock market higher in character than the securities of public service corporations of other States where the franchise rights are granted in perpetuity. For instance, stock like the West End Street Railway Company's is selling on a basis of less than 4 per cent. return to the investor,—a basis as favorable to the company as the first mortgage bonds of the greatest railway companies, as favorable as the bonds of many of the richest cities of the Union. The same is true of the stock of the Edison Electric Illuminating Company of Boston.

The circulars of the bankers and brokers offering bonds and stocks of public service corporations of other States generally end with the statement that, in the "opinion of the counsel, the rights and privileges are perpetual," or are "for long terms of years." We have nothing of that sort here in Massachusetts; but we have something which to the mind of the average investor is proved to be worth even more. We have a system by which the public service company is sure of its rights as long as it deals justly with the community; and the knowledge that this continued existence is dependent upon the good will of the people protects the companies from committing arbitrary or unjust acts which would incite public indignation and lead to the curtailment or destruction of their rights. Our system leads the public service corporations to act justly; and just action thus attained insures to them a continuation of their privileges.

The conservative classes in the community are not those who wish to leave unrestricted the power of wealth, but those who in economic relations are working for justice to capitalist and to the public alike. In that position the Massachusets State Board of trade stands. In that spirit the Massachusetts State Board of Trade has come here to present its petition for the enactment of a general law providing for the consolidation

of gas and of electric lighting companies without permitting as a special privilege to any company the right of watering its stock.

I say, therefore, gentlemen, when you come to deal with this question, deal with it by passing a general law to which there is no exception.